

# ANALYSIS OF AMENDED BILL

## Franchise Tax Board

Author: Scott and Alpert Analyst: Norman Catelli Bill Number: SB 760  
Related Bills: See Legislative History Telephone: 845-5117 Amended Date: April 30, 2003  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** FTB Study Sales & Use Tax Exemption & Report Revenue Loss for Use of Lease/Leaseback Financing Transactions by Transit Agencies

### SUMMARY

This bill provides a state and local sales and use tax exemption for specified sale and leaseback transactions of public passenger transportation vehicles.

This analysis addresses only those provisions of the bill affecting the Franchise Tax Board (FTB).

This is the department's first analysis of this bill.

### SUMMARY OF AMENDMENTS

The April 30, 2003, amendments would:

- Require the Legislative Analyst's Office (LAO) to consult with the FTB on a study of the impact of this exemption and report to the Legislature by January 1, 2008,
- Require public transit agencies using sale and leaseback transaction to furnish certain information to the FTB, and
- Require the FTB to report, every other year, on the revenue loss to the state, if any, of personal and corporation taxes resulting from these transactions.

### PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to assist public transportation agencies in the purchase and lease of mass transit vehicles such as buses, ferry boats, locomotives, and related equipment.

### EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment, and by the specific terms of the bill would be operative on the first day of the first calendar quarter commencing more than 90 days after the effective date of this bill.

### POSITION

Pending.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Gerald H. Goldberg

6/25/03

## **ANALYSIS**

### FEDERAL/STATE LAW

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business, including expenses associated with the leasing of vehicles. Existing state and federal laws generally allow as a depreciation deduction a reasonable allowance for the exhaustion, wear, tear, and obsolescence of property used in a trade or business or property held for the production of income. Some available depreciation methods provide for “accelerated depreciation”, i.e., a larger deduction is allowed in the earlier years, offset by a smaller deduction in the later years.

The purpose of these sale and leaseback transactions is to allow a tax-exempt public entity to get a financial benefit by transferring the depreciation deduction on certain transit equipment to a taxable entity that can use the deduction to offset taxable income.

However, Internal Revenue Service Revenue Ruling 99-14, I.R.B. 1999-13, 3, (March 11, 1999), 1999-1 CB 835, provides that a taxpayer may not deduct rent or interest expenses associated with a lease-in/lease-out transaction if that transaction lacks economic substance other than tax benefits. A lease-in/lease-out transaction occurs when an entity leases an item to another entity that leases that item back to that entity.

Currently, state law allows the Department of Transportation (DOT) to purchase, sell, or lease mass transit vehicles (by negotiation without competitive bidding) to give the purchaser the advantage of the accelerated cost recovery method of depreciation provided by federal law. In addition, the transactions between DOT and the purchaser in these instances are not considered a sale or purchase for purposes of the sales and use tax laws.

### THIS BILL

This bill would:

- Extend the sales and use tax exemption until January 1, 2009, for specified sale and leaseback transactions undertaken by public entities,
- Require the LAO to report to the Legislature on the impact of this exemption by January 1, 2008,
- Require that certain specified information be furnished by the public entity to the FTB, and
- Require the FTB to review the furnished information and report every two years to the LAO, the Senate Committee on Revenue and Taxation, and the Assembly Committee on Revenue and Taxation on the revenue loss to the state, if there is any.

### IMPLEMENTATION CONSIDERATIONS

Implementing the bill would not significantly impact the department’s programs and operations.

## **LEGISLATIVE HISTORY**

AB 984 (Papan, Ch. 592, Stats. 2001) exempts, until January 1, 2004, transportation related sale-leaseback transactions from the sales tax, and required the LAO to prepare a report on the impact of the sales tax exemption by January 1, 2003.

## **OTHER STATES' INFORMATION**

Because this reporting requirement is unique to California law, a comparison to other state's laws would not provide meaningful information.

## **FISCAL IMPACT**

The extent to which the department would consult with the LAO is unknown, however, the department's costs are expected to be minor.

## **ECONOMIC IMPACT**

There are currently no transaction data available on which to update the revenue estimate contained in our analysis of AB 984 (Ch. 592, Stats. 2001), which was projected to be a negligible<sup>1</sup> to minor<sup>2</sup> revenue loss over the first three fiscal years.

This amendment requires FTB to report every other year on the revenue loss to the state resulting from the sale/leaseback and lease/leaseback transactions of qualified equipment. Therefore, the actual state income tax revenue loss impacts would be provided as required after this bill is implemented.

The FTB defers to the Board of Equalization for the impact of the extension of the sales tax exemption to January 1, 2009, as provided for in the bill.

## **LEGISLATIVE STAFF CONTACT**

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<sup>1</sup> Negligible means less than \$250,000 per year.

<sup>2</sup> Minor means less than \$500,000 per year.